REHABILITATION OF CONDOMINIUMS: OPTIONS FOR SLOVAKIA

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1. INTRODUCTION[1]

The objective of this report is to analyze the options for financing renovations in condominiums. Multi-family buildings with privately owned apartments have existed in many countries of Central and Eastern Europe since the early 1900s (for example Hungary, Ukraine, Romania etc.). However, the transition of many of these countries from a planned to market economy has lead to the emergence of new kinds of condominiums. The transfer of public housing from central to local governments and its subsequent privatization has lead to the appearance of condominiums which are very different from those in the western world and even from those already existing within these countries. Years of deferred maintenance and rehabilitation due to low rents and inefficient management of publicly owned management firms, has culminated in buildings which are in a very poor condition. In some cases even the structural elements and engineering systems are in critical need of repair. The new owners now face the challenge of financing the rehabilitation of their private units as well as the common areas of the condominium.

While oriented towards the economic environment in Slovakia, this report is applicable to several other countries of Central and Eastern Europe. Even in Slovakia the condition of the buildings, income profile of the owners, commercial bank interest and availability of funds at the local level may make one financing option more relevant than another.

This paper starts with a brief overview of housing reform, the banking system, and condominium law in Slovakia. It then proceeds with the options for financing rehabilitation. Finally, some hypothetical examples help clarify the choices available to condominium associations under a specific financing scheme.

2. OVERVIEW

Before and since the division of the Czech and Slovak Republic in 1993, Slovakia has followed a path of economic transformation similar to other former socialist states. There was a initial sharp drop in output, high inflation due to price liberalization, and a change in import orientation. Even though the country now appears to be moving in the direction of macroeconomic stability, substantial changes and reforms are needed in the housing and banking sector.

The Housing Sector

The housing sector in Slovakia continues to combine socialist-era housing policies along with market reform. Former state-owned housing has been transferred to municipalities who are slowly privatizing their housing stock (10 percent). Condominium associations account for approximately 40 percent of privatized housing. There is a large cooperative sector (22 percent)

[1] I would like to thank Harold Katsura, Sheila O'Leary and Christopher Banks of The Urban Institute for their insightful comments and feedback while researching this paper.

which is to be privatized, and 50 percent of the housing stock is owner-occupied, mostly in the rural areas or on the outskirts of large cities. Rentership is the most dominant form of tenure in urban areas, and rent control and strong tenant property rights continue to exist.

Multi family apartment buildings are being sold to tenants at an extremely nominal value. Local governments set a 2 percent rate of annual depreciation on the original value of the house (at the time of construction), thus leading to cases where tenants pay a fraction of the true value of housing when it is privatized. If the "sale price" of the house is beyond the means of the tenant, he/she has the option of taking a 10 year loan at a zero rate of interest from the government. This process of privatization has not lead to substantial revenues for the local governments. Despite this, there is a stipulation in the law that a certain percent of revenues obtained from the privatization of housing has to be deposited into a Municipal Development Fund and reinvested in the housing sector or housing related infrastructure.

At this point there are limited housing finance mechanisms in Slovakia. The government ended its provision of low-interest mortgages (at 1 percent interest rate) for a 30 year period in 1991, and a private sector housing finance system is yet to develop. Eviction and foreclosure, though legally possible under the terms of the civil code, are not yet practical options due to the requirement that alternative housing has to be provided for the evicted household.[2] Two contract saving institutions modeled after the Bausparkassen in Germany were created in 1992 and their potential as a source of funds for unit rehabilitation will be examined below.

The Banking System

As of February 1996, there are 30 commercial banks operating in Slovakia (26 in July 1994). However, relative to the needs of the country, banks in Slovakia are cash poor. As stated by Lea and Mikelsons (1994), the rate of growth of bank deposits was less than the inflation rate over the period 1992 to 1994, and the subscribed base capital of commercial banks grew only 6.1 percent in 1993, which was less than the rate of inflation over the period. From mid-1993 to mid-1994, total deposits in the commercial banks increased, but fell short of the 18 percent inflation rate by approximately 10 points.

Most of the bank credits are short term (less than one year). At the maximum, banks lend for 5 years at a market rate of interest up to 16 percent. This is usually for construction purposes, and depending on the product and duration of the loan, banks charge a different rate for 1, 3 and 5 year loans. Additionally, commercial banks other than the Slovak Savings Bank are relatively illiquid and reluctant to extend long-term credit.[3] In this environment there are few options to

[2] Due to this reason the report will not focus on the issue of property being used as collateral in obtaining rehabilitation finance.

[3] From 1969 through 1990, the Slovak Savings Bank was the most dominant bank catering to household savings. As recently as 1991, the bank provided 30 year fixed-rate loans at 1-3 percent interest rates for a maximum of SK 150,000 after a underwriting process to individual households for the construction or purchase of family houses.

finance either the construction of new houses or rehabilitate the existing ones. The Slovak Savings Bank which was originally under state ownership was converted into a private commercial bank (joint stock company) called the State Savings Bank in November 1995. This bank now provides credit for housing related purposes for 10 to 30 years at an interest rate of 12.5 percent. However, this rate is still considered high for private housing construction.[4]

The Current Condominium Law

The Condominium law (No. 182) was passed in 1993 and later amended by Law 151 passed on June 23, 1995. The main feature of a condominium association is that owners of individual units have property rights not only for their unit, but also for a certain proportion of the common areas of the condominium. Owners are therefore obliged to share the coverage of cost of operation, maintenance, and repairs of the common parts and common equipment of the condominium. The costs are shared in proportion to the respective share of ownership, and payments are made monthly to a condominium fund. The amount of payments are set by a majority vote (more than 50 percent) of the owners, each owner having one vote for each apartment and non-residential space.

The condominium law also provides for a third party lien on the owner occupied apartment and common areas of the condominium. This lien has to be fulfilled at the time of sale or transfer of the property from the original to a new owner. If a unit in a condominium association is rented, the original owner has to provide alternate housing for the tenant if wanting to evict him/her for non-payment or other legally recognized grounds for eviction.

3. OPTIONS FOR FINANCING REHABILITATION

In an ideal environment, condominium associations would finance their own rehabilitation. If renters choose to become owners, they should accept all the responsibility associated with being a private owner. Given the lack of adequate market finance in Slovakia, this is the first option explored. However, it is acknowledged that in certain cases, condominium associations may need to approach either the bank for a loan or get assistance from the local governments. Therefore, cases where this may be necessary and optimum are examined. Finally some non conventional finance schemes are also explained briefly.

Condominium Income

It is important to keep in mind that condominium fees, special assessments (whereby a one time lump-sum payment is due from all members in addition to their monthly fee payments to pay for a specific repair or improvement) and investment income (a capital reserve fund is built up from the monthly condominium fees which is later invested and gives rise to earned income) are the only sources of income for a condominium association to pay for rehabilitation. Even if

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[4] There are questions regarding whether this lower rate of interest (12.5 percent) is applicable for loans made directly to condominium associations. However, this may be resolved via negotiations with the bank.

an association were to take a loan, it would have to repay the loan from its projected income stream. Therefore, the ideal situation is for members of the association to use their own resources in funding rehabilitation. With special assessments and fee increases a capital reserve fund can be built up over time and used to finance rehabilitation.

It is always true that some members of the association will not want to (free riders) or legitimately cannot (low income) pay higher fees or special assessments.[5] In these cases a lien can be placed on the property. Since the units are not financed through a mortgage, which would otherwise have first lien priority, the condominium association will have first claim on the unit at the time of sale/transfer. The problem with this is that the additional burden of financing the rehabilitation will be placed on members who have the means to make the additional payment.

However, since the creation of condominiums in Slovakia (1993), some condominium associations have been building up their capital reserve fund. For example, unit owners pay up to SK 1500 - 2000 per month for condominium fees. Seventy percent of this is payment for heating and water. The remaining is for electricity and common areas, and approximately SK 300 - 400 per month is put into a capital reserve fund. Such capital reserve funds should be used to finance the rehabilitation of the common areas of the condominium.

Local Government Role

The local or city government may need to, and should leverage the rehabilitation of condominium associations in two cases: 1) when a significant number of home owners are pensioners or low-income households, and 2) when the building condition is life threatening and rehabilitation is required immediately. In these cases the condominium association may not have the time to build up its own capital reserves and will therefore have to find immediate financing from other sources.

If government intervention and help is required in the above cases, it should preferably be in the form of a clear and transparent grant. This is administratively easier and cheaper for the government. As far as possible the grant should be matching (for example the government could match a certain proportion of every SK contributed by the low-income household or pensioner) in order to leverage the amount contributed from a owners own income. A matching grant is the best possible form of government help; it ensures that the recipient uses the grant for the stated purpose and also stimulates own resources of the recipient. Given that a certain percent of the proceeds from privatization are to be reinvested in the housing sector in Slovakia, this grant subsidy from the government could be financed from the Municipal Housing Development Fund.

A condominium association has the responsibility to build up adequate reserve funds to self-finance any rehabilitation. However, in certain life threatening situations the rehabilitation may

[5] This is specially valid in the countries of Central and Eastern Europe where units were assigned depending on the household's number in the "queue", and therefore led to households from extremely different income ranges residing in a multi-family apartment building.

be required immediately and not at some future date when enough funds have been accumulated. In such situations the condominium association should approach commercial banks for a loan at the market rate of interest. This loan would be granted after the bank's assessment of the condominium's ability to repay the loan based on the condominium's future stream of (projected) income. It is possible, though, that the market rate of interest is too high, and the period of loan repayment is too short for the association. In these cases government help would be required to leverage the amount of loan borrowed by the association in the market. This should also be in the form of a matching grant. The local government should not get into the business of lending to the condominium association - that is the role of commercial banks.

Thus the suggested role of the government is to leverage private funds and assist the most needy households or most urgent rehabilitation through a system of matching grants. Grants are transparent subsidies that are relatively easy to administer, and the size of the grant can be adjusted according to the demand and need. The government can define the program parameters (matching ratio, cost limit, eligible expenditures, poverty line, etc) and then let condominium associations apply for the funds.[6]

Local governments could also assist condominium rehabilitation in three other ways which will be discussed to a greater extent below. They could use the Municipal Development Fund account for partial guaranty of loans taken by condominium associations from commercial banks; decide which projects will be applicable for revolving loan funds; and, give technical assistance to the commercial banks.

Bank Loans

In general, a condominium association should approach a commercial bank for a rehabilitation loan only when it has not yet accumulated sufficient capital reserves and needs to undertake the repair of the building immediately. The bank will grant the loan based on the future stream of income resources of the condominium association. If the market rate of interest if too high, the association could get a matching grant from the government, but as stated above, this should only be in cases where there is a life-threatening situation requiring immediate rehabilitation of the building.

Local governments sometimes also guarantee or insure the loan taken by condominium associations from commercial banks. This is done when the association is considered “risky” (due to low income households) with a high probability of defaulting on the loan, and therefore banks are not willing to grant a loan without a government guarantee. This system of finance should be avoided in underdeveloped financial systems. It removes incentives for banks to make good decisions and creates incentives for associations to default. An alternative to a government

[6] It is administratively easier for the government to deal with the condominium association rather than individual households in determining the matching grant. Therefore a certain upper bound could be set for matching funds to condominium associations, based on the proportion of low income households and pensioners in the building.

guarantee could be wage garnishment (payroll deductions) of members of the condominium, third party guarantees, or good character references.[7]

Revolving Loans

Revolving loans agreements made by banks are generally classified as short-term credit arrangements. It becomes binding upon the bank to assure short-term funds, up to some specified limit, for a specified period of time, at an interest rate generally tied to the time-varying prime rate. Customers are often charged a commitment fee for this arrangement. In addition, they also have to provide some compensating deposit balance. These short term credits usually have a high monitoring and transaction cost and are subject to banking regulation laws, and the ability of large commercial banks to raise short-term loans.

The objective of a revolving loan fund is to return loan payments from individual borrowers to a fund from which other families and associations can subsequently borrow. A bank would voluntarily set up a fund, earmark a certain amount of fixed revenue to it and use it for revolving loans, only if it is a profitable venture. However, as stated above, there are high transaction and monitoring costs associated with these loans, and therefore this activity has traditionally been done by intermediary organizations such as cooperative housing federations, credit union federations and non-profit or non-government organizations. Local governments usually assist in the establishment of revolving loan funds in two ways: 1) provide technical assistance to strengthen these institutions, by increasing their capacity to mobilize and manage financial resources and improve cost-recovery techniques. 2) provide institutional support grants.

The view in developed countries has always been that housing finance institutions should compete for deposits on equal terms with other financial institutions; the role of directed credit should be minimized. However, in Slovakia, where banks are already relatively illiquid, the local government may need to play a role in providing capital - from the municipal development fund account - to the banks to set up a revolving loan fund. However, it is important that the municipality loans the amount to the bank at the rate of inflation in the economy. This is necessary for two reasons: 1) a grant from the local government (which does not need to be paid back) would not give any incentives to the bank to make sound financial decisions, and, 2) if the amount loaned to the bank is at a rate of interest less than inflation, the real value of the revolving fund would decrease over the years and require further and repeated capital loans by the local government.

As stated above, the role of local governments as providers of capital is usually not recommended. However, it is preferable compared to the government playing a role as direct producers of housing. That role must necessarily be performed by the formal or informal sector. According to the World Bank (1993), “Governments have retreated from ambitious public housing programs that demanded heavy yet unsustainable subsidies and have increasingly opted for

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[7] The government could also give a partial guarantee for the loan. For example, only the first 50 percent of the loan could be guaranteed, so that the bank takes on a greater role in project analysis and risk.

programs focusing on assistance, rather than direct production....In general, the move has been away from the role of government as producer, to a new role as enabler, facilitating and encouraging housing activities by the private sector."

Once the revolving loan fund has been established by the bank (based on the capital loan of the municipality), the local government could play a further role, by providing technical assistance to the bank. The eligibility criteria for the revolving fund loan should also be via both the banks and local governments assessment of various rehabilitation projects and joint underwriting of the condominium association. A hypothetical numerical example for a revolving loan scheme by the banking sector is provided later is this paper.

Contract Saving Schemes

Slovakia currently has two banks providing what is locally known as construction saving schemes.[8] The advantage of a construction saving scheme is getting a low interest loan, based on gradual planned saving supported by a State bonus. The State contributes 40 percent of the amount saved in the year with a ceiling contribution of SK 6,000 per year. Thus the ideal annual deposit is SK 15,000 and an ideal projected amount is SK 250,000 for a regular 6 year long saving. Individuals can take out the deposit and State subsidy in 3 months after the initial deposit, but will have to forfeit the interest on the total amount. After the first 3 months there is a 3 percent rate of interest on the total savings of the individual. A depositor is allowed to draw down on the accumulated amount (payable in 8 or 13 years) at a 6 percent rate of interest, if the credit is taken before 2 years, the interest rate is 10 percent.[9]

The above scheme is beneficial to the banks because of fees (banks get 1 percent of the targeted sum when the account is opened: if the depositor withdraws within the first 3 months the fee is waived), penalties, interest spread and interbank loans. Depositors benefit because they have access to a long term loan with a low interest rate for the purchase, construction, modernization and reconstruction of houses and flats. The loan has to be used for a housing related purpose and the bank pays directly against the deposit up to the amount in the account. Individual home owners therefore have the options of using their private savings for rehabilitation of the common areas of the condominium.

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[8] *Slovenská sporitel'ňa* (Slovak Savings Bank, j.s.c.) in collaboration with *Bausparkasse Schwäbisch Hall AG* (from Germany) and *Raiffeisen Bausparkasse GmbH* (from Austria) set up the *First Construction Saving Bank* in 1991. Law No. 310/1992 of the Collection of Laws on the Construction Saving was approved by the Slovak National Council in May 1992, and the *First Construction Saving Bank* started its operation in November 1992. The construction saving bank *VÚB Wüstenrot*, j.s.c. was set up in March 1993, and became operational in June 1993. It was founded by *Všeobecná úverová banka,* j.s.c.(50 percent), *Bausparkasse Wüstenrot Salzburg* (30 percent) from Austria and *Holding Wüsterot Ludwigsburg* (20 percent) from Germany.

[9] Both the interest and the State bonus is tax free.

Currently condominium associations cannot enter into contract with the construction banks. Only individuals are eligible. However, the association can, for example, collect invoices from all the home owners in the condominium association and the bank would have to honor the invoice. A condominium association can also make an agreement with all the owners that they can withdraw funds from their account only after obtaining permission from the association. This would prevent home owners from taking loans for private rehabilitation of their own apartment, and using the construction saving loan only for rehabilitation of the common areas of the condominium.

Construction saving has become very popular in Slovakia. According to TREND magazine 1 of every 9 citizens in the Slovak Republic has become a construction saver in the last two and a half years. Despite this, it might be wise to view this phenomenon as a temporary and non-primary source of housing finance. As shown by Diamond and Lea (1992), the experience of other developed countries has been that political and market forces eventually erode both the reasons for having contractual saving schemes and the ability to maintain them.

The major factor leading to the decline of these saving institutions is inflation, which results in volatile interest rates. This inevitably leads to a restrictive monetary and fiscal policy and an eventual slowdown in the housing market. High inflation in the economy devalues the savings, and if the government begins to follow a restrictive monetary policy increasing interest rates in commercial banks, individuals may find it beneficial to withdraw funds from contractual saving banks and make deposits into commercial banks. Also, increased fiscal pressure may cause the government to decrease the amount of bonus given to contractual saving banks. Finally, financial market deregulation may remove constraints on the supply of mortgage credit thus giving rise to alternate sources of housing finance.

Non Conventional Finance

Sometimes conventional financial institutions may not be the optimal solution for financing and rehabilitating housing for low-income households. The eligibility criteria (middle to high income, record of regular saving, and regular employment) as well as the conditions (the sum lent, date of full repayment, rate of interest, the pattern of repayment of principal and interest, any indexing arrangement, action if the borrower defaults or falls into arrears) of the loan may exclude the poor. Also, the minimum loan size available from a bank (to cover the cost and have a margin of profit) may be larger than the amount required for the repair. Thus rural and urban poor have had to create and rely on their own saving schemes. The most wide spread are the rotating saving schemes and credit unions (also known as financial cooperatives or community-based financial institutions). A condominium association already serves the same function as a rotating saving scheme[10]—under a more legal and formal structure. But the option of a financial cooperative has not been tried in Slovakia.

■ **Financial Cooperatives.** A financial cooperative can be formed by a group of individuals having a common bond (residence in the same neighborhood, employment in the same workplace, or membership of a common ethnic or religious group) who form a society to enable them to save and borrow. Loans are usually made by the cooperative to its own members and it is run by a board elected by those members. A financial cooperative can be small with less than 100 members, and it has a special legal status which enables it to enjoy tax advantages as well as freedom from the controls government exercises over other financial institutions.

A financial cooperative is dependent on its members being a group of savers, and the saving instruments offered by a financial cooperative are two-fold. One is the purchase of shares in the institution - which pays a dividend, and second is a deposit facility - which yields a rate of interest.[11] According to Merrett and Russell (1994), the attractions of cooperative membership are the reward on saving, the money guard facility (opportunity to place savings safely with an institution) and most important of all is that the record of saving is a necessary condition of access to a future loan. Some cooperatives also offer contractual saving schemes. Under this an agreement is made between the saver and the financial cooperative whereby the saver accumulates a given sum by a specified date and then receives a loan of a pre-determined value.

The problem with a financial cooperative offering contractual saving schemes is that it is dependent on the regular savings of its members. Also high inflation in the economy could lead to a negative real rate of interest on the savers' deposits.

The main advantage of a condominium association forming its own financial cooperative is that, along with individual members having access to loans for private use, the association would also have access to funds for rehabilitation. As stated above, the construction saving scheme currently existing in Slovakia is applicable only to individuals and not to associations. A condominium association would only need majority vote to access the funds as opposed to invoices by each of its members for the construction saving scheme. Another advantage is the common bond of the members of the cooperative. Since loan default affects other coop members, they will and can exert strong pressure on borrowers to repay their debt in full. A cooperative could also seek a more feasible collateral from its members such as a vehicle, a

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[10] A small group of individuals (usually 6 or 10) form a group and select a leader. The association meets on a periodic basis when each member is required to pay an agreed sum of money. The entire sum collected at a meeting is loaned to one member of the group - usually interest-free. The recipient is different each time on a rotating basis, until all the group members have had their turn. Then the cycle begins again. The advantage of this scheme is that it provides group pressure to save, and gives members access to much larger sums of money than would otherwise be possible.

[11] The rate of interest is usually less than that offered by the commercial banks.

domestic appliance, and so forth. Risk can also be reduced by deducting monthly payments from members salary or wages.

4. HYPOTHETICAL FINANCIAL EXAMPLE

Earlier analysis of the kind of rehabilitation work required by different condominium associations in Slovakia has lead to an identification of three kinds of repairs: small repair (costing approximately SK 500 to SK 200.000), medium size repair (costing approximately SK 200.000 to SK 2 million), and finally major repairs (costing greater than SK 2 million). We will examine the financing of two repairs. One a medium size repair costing SK 1.500.000 and the other a major repair costing SK 2.580.000.

Since several condominium associations have already built up a capital reserve fund for approximately 18 months we can assume that they have the capacity to undertake small repairs of the condominium (usually done by the owners themselves with materials bought from the capital reserve funds). Therefore the need of the condominium association to approach a bank for a loan, arises only in the case of medium or large repairs. The following hypothetical example also supports this assumption.

Assumptions

- Number of units in the condominium association = 100
- Monthly condominium fees = SK 1500
- Number of households paying condominium fees = 100
- Amount put into capital reserve fund = SK 300 per unit per month
- Amount of reserve funds after 18 months = SK 540.000[12]

Table 1
Monthly Payments for a Medium Repair Loan (SK 1,500,000)

Assumptions: SK 960,000 loan + SK 540,000 capital reserve Loan term=7 years (84 months)			Assumptions: SK 960,000 loan + SK 540,000 capital reserve Loan term=3 years (36 months)		
Interest Rate (percent)	Total Monthly Payment	Monthly Payment per Unit	Rate of Interest	Total Monthly Payment	Monthly Payment per Unit
19.0	20,743.70	207.44	19.0	35,189.78	351.90
18.0	20,177.12	201.77	18.0	34,706.30	347.06
17.0	19,618.37	196.18	17.0	34,226.62	342.27
16.0	19,067.58	190.68	16.0	33,750.75	337.51
15.0	18,524.88	185.25	15.0	33,278.72	332.79
14.0	17,990.41	179.90	14.0	32,810.52	328.11

[12] Thus confirming the assumption that small repairs can usually be done by the condominium association.

13.0	17,464.28	174.64	13.0	32,346.19	323.46
12.5	17,204.39	172.04	12.5	32,115.48	321.16
12.0	16,946.62	169.47	12.0	31,885.74	318.86
11.0	16,437.54	164.38	11.0	31,429.17	314.29
10.0	15,937.14	159.37	10.0	30,976.50	309.77
9.0	15,445.52	154.46	9.0	30,527.74	305.28
8.0	14,962.77	149.63	8.0	30,082.91	300.83
7.0	14,488.97	144.89	7.0	29,642.01	296.42

— Bank rate of interest = 16 percent per year
— Rate of interest charged by the State Saving Bank = 12.5 percent per year
— Loan term = 3 years or 7 years

Table 1 shows the monthly payment per unit for a medium repair loan taken from a bank. The analysis has been done for different bank interest rates and for a loan term of 3 years and 7 years. The table shows the different options facing both banks and condominium associations, and is based on the assumption that the condominium association has given its entire capital reserve of SK 540,000 to the bank as downpayment for the loan.

■ **Options for the Bank.** The decision of the bank regarding the loan term and type of loan, effects the rate of interest it charges and the amount of funds it has available for revolving loans. A longer loan term implies a greater risk for the bank (inflation, changes in the economy both political and fiscal effecting bank policy, etc), and therefore it would charge a higher rate of interest on the loan. On the other hand, short term loans are usually charged a lower rate of interest. The bank could also agree to either a signature loan whereby it transfers the entire loan amount over to the condominium association, which then has the responsibility of using it optimally. Or, the bank could monitor the loan and draw down the amount only on receiving the invoices for work done on the condominium. This second type of loan would have higher overhead costs for the bank (monitoring and verifying the invoices of the condominium), but would have the advantage of giving the bank a larger pool of funds to rotate as loans to different condominiums.[13]

■ **Options for the Condominium Association.** The loan term effects the monthly payment of each owner in the condominium association. Table 1 shows that decreasing the loan term by more than half - 53 percent - (from 7 to 3 years) increases the amount of monthly payment by 56 percent. In choosing the loan term (assuming it has a choice), the condominium association should keep in mind that in addition to repaying the loan to the bank, it should also

[13] If the condominium association does not drawn down the entire loan amount and the bank pays the invoices directly, then the bank could give out more loans at any given point in time (apposed to just 3 or 4 loans which sum up to the capital), since the amount loaned to any condominium association would only be drawn down over the entire loan term as the rehabilitation progresses on the building.

start building up its capital reserves again which have been completely depleted in taking the loan. In the above example, a loan term of 7 years at a 16 percent rate of interest implies a monthly payment of SK 191 from each unit owner. Since originally SK 300 from each unit was being put in the capital reserve fund per month, this loan term allows the condominium association to both "afford" the loan as well as start building up its capital reserves again. On the other hand, a loan term of 3 years implies

Table 2
Monthly Payments for a Major Repair Loan (SK 2,580,000)

Assumptions: SK 2,040,000 loan + SK 540,000 capital reserve Loan term=7 years (84 months)			Assumptions: SK 2,040,000 loan + SK 540,000 capital reserve Loan term=3 years (36 months)		
Interest Rate (percent)	Total Monthly Payment	Monthly Payment per Unit	Rate of Interest	Total Monthly Payment	Monthly Payment per Unit
19.0	44,080.36	440.80	19.0	74,778.28	747.78
18.0	42,876.39	428.76	18.0	73,750.89	737.51
17.0	41,689.04	416.89	17.0	72,731.56	727.32
16.0	40,518.61	405.19	16.0	71,720.35	717.20
15.0	39,365.38	393.65	15.0	70,717.27	707.17
14.0	38,229.62	382.30	14.0	69,722.36	697.22
13.0	37,111.61	371.12	13.0	68,735.66	687.36
12.5	36,559.33	365.59	12.5	68,245.40	682.45
12.0	36,011.57	360.12	12.0	67,757.19	677.57
11.0	34,929.77	349.30	11.0	66,786.98	667.87
10.0	33,866.42	338.66	10.0	65,825.06	658.25
9.0	32,821.72	328.22	9.0	64,871.45	648.71
8.0	31,795.88	317.96	8.0	63,926.19	639.26
7.0	30,789.07	307.89	7.0	62,989.28	629.89

Table 3
Monthly Payments for a Major Repair Loan (SK 2,580,000) with Larger Capital Reserves

Assumptions: SK 1,860,000 loan + SK 720,000 capital reserve Loan term=7 years (84 months)			Assumptions: SK 1,860,000 loan + SK 720,000 capital reserve Loan term=3 years (36 months)		
Interest Rate (percent)	Total Monthly Payment	Monthly Payment per Unit	Rate of Interest	Total Monthly Payment	Monthly Payment per Unit
19.0	40,190.92	401.91	19.0	68,180.20	681.80
18.0	39,093.18	390.93	18.0	67,243.46	672.43
17.0	38,010.60	380.11	17.0	66,314.07	663.14
16.0	36,943.44	369.43	16.0	65,392.08	653.92

15.0	35,891.96	358.92	15.0	64,477.51	644.78
14.0	34,856.42	348.56	14.0	63,570.39	635.70
13.0	33,837.05	338.37	13.0	62,670.75	626.71
12.5	33,333.50	333.34	12.5	62,223.74	622.24
12.0	32,834.08	328.34	12.0	61,778.62	617.79
11.0	31,847.73	318.48	11.0	60,894.01	608.94
10.0	30,878.20	308.78	10.0	60,016.97	600.17
9.0	29,925.69	299.26	9.0	59,147.50	591.48
8.0	28,990.36	289.90	8.0	58,285.64	582.86
7.0	28,072.38	280.72	7.0	57,431.40	574.31

larger monthly payments from each unit. However, this might be preferable to the members of the condominium association, if all the unit owners can pay special assessment or a larger fee and therefore repay the loan back faster.

Table 2 shows the monthly payments due from each unit of a condominium association if it took a larger loan from the bank to make major repairs (based on the assumption that the entire capital reserve is also used). It is not surprising that the monthly payments are substantially higher than in the case of a smaller loan to make a medium size repair. If the condominium association were to build up its capital reserves only for an additional 6 months (total of 2 years) before taking a loan from the bank, the amount of monthly payment would fall substantially. This is shown in Table 3. Another option is to charge special assessment and build by a capital reserve fund faster and take a loan earlier.

5. CONCLUSIONS

Several owners associations in Slovakia have already taken the first step towards the rehabilitation of their building - they have established the practice of building up capital reserve funds. The objective now is to motivate and convince the owners that rehabilitation of the common areas is for the common good of the owners. It improves the property value, effects the value of the town, leads to a safer environment, and improves the quality of life.

The best practice in financing rehabilitation is for the condominium association to rely on its own reserves and income. Only in the case of low income households and pensioners should the local government give a matching grant to leverage the contributions of these unit owners. Given the specific circumstances of underdeveloped banking finance in Slovakia, the local government could also play a role in helping to set up a revolving loan fund and provide technical assistance to commercial banks. The technical assistance could specifically involve information sharing (knowledge about individuals who are receiving matching grants from the government) and criteria used in identifying associations which require urgent rehabilitation.

Only in the case of urgent rehabilitation requirement, should the local government leverage the financing of the repair. In this case the burden of the entire cost cannot be born by the condominium association in time and the fact that the buildings were not rehabilitated before sale implies the responsibility of the previous owners - usually the local government. Since the local governments are obliged to reinvest in the housing sector the proceeds from privatization, it is important that the funds are used to salvage and improve the value of the existing housing stock instead of creating new units.

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